Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Box A: **QB 1 – January 2021**

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The International Outlook

By Monetary Policy Division

In the second half of 2020, the global economy partly recovered from the depths to which it had plummeted during the first half of the year. Moreover, progress with COVID-19 vaccines and the start of their rollout lifted expectations and uncertainty receded. But the global economy's path back to pre-pandemic levels of activity remains prone to setbacks: as the COVID-19 pandemic continues to spread, many countries are reinstating partial or full lockdown and concerns are increasing that the escalation of infection rates associated with new mutant COVID-19 strains observed in some countries could penetrate borders over the coming months. After a fall of 4.2 percent this year, the OECD expects global GDP to rise by 4.2 percent in 2021 and a further 3.7 percent in 2022 (December 2020 forecasts). In October, the IMF projected global growth to be −4.4 percent in 2020, to rebound at 5.2 percent in 2021, and gradually slow to about 3.5 percent over the medium term. As forecasts rest on factors that are inherently difficult to predict, the uncertainty surrounding them is unusually large at present.

Euro area quarterly GDP increased by 12.5 percent in the third quarter of 2020, after having decreased by 11.7 percent in the previous quarter. Despite being the sharpest increase observed since the series started, the rebound in the third quarter did not offset the loss registered in the first half of the year, with GDP down by 4.3 percent compared with the same quarter of the previous year. In October, the euro-area unemployment rate was 8.4 percent, down from July's high of 8.7 percent but 1.2 percentage points higher than it was in February. After a steep decline in November, the Markit Eurozone Composite PMI (flash reading) rose from 45.3 to 49.8 in December, signalling that business activity came close to stabilising as stronger manufacturing output growth helped to counter a further drop in service sector activity. In December, the ECB revised its GDP growth projections for the entire forecast horizon; euro area GDP is now expected to have decreased by 7.3 percent in 2020 (up from the September forecast of −8.0 percent), before increasing by 3.9 percent in 2021 (down from 5.0 percent), 4.2 percent in 2022 (up from 3.2 percent), and 2.1 percent in 2023.

Euro area annual HICP inflation was –0.3 percent in November 2020, stable compared with October. While negative headline inflation was mainly due to decreasing energy prices (–8.3 percent), underlying inflation remained subdued, with HICP inflation excluding energy and unprocessed food increasing by only 0.4 percent (stable compared to October). ECB projections for euro area inflation remained broadly unchanged, with an annual HICP inflation rate of 0.2 percent expected in 2020 (down from the September forecast of 0.3 percent), 1.0 percent in 2021 (unchanged), 1.1 percent in 2022 (down from 1.3 percent), and 1.4 percent in 2023.

In view of the economic fallout from the resurgence of the pandemic, in December the Governing Council (GC) of the ECB decided to increase the envelope of the pandemic emergency purchase programme (PEPP) by €500 billion to a total of €1,850 billion. The GC also decided to extend the reinvestment of principal payments from maturing securities purchased under the PEPP until at least the end of 2023, and to extend by twelve months, to June 2022, the period over which considerably more favourable terms will apply on the third series of targeted longer-term refinancing operations (TLTRO III). Forward guidance on the key ECB interest rates and the asset purchase programme (APP) remained unchanged.

In the United States, quarterly GDP increased by 7.4 percent in the third quarter of 2020 (after decreasing by 9.0 percent in the second quarter of 2020); compared with the same quarter of the previous year, GDP was lower by 2.9 percent. In November, the unemployment rate edged down to 6.7 percent, 8 percentage points lower than its recent high registered in April, but still 3.2 percentage points higher than it was in February.

At its December meeting, the Federal Open Market Committee (FOMC) of the US Federal Reserve maintained the target range for the federal funds rate at 0 to 0.25 percent. The FOMC expects it will be appropriate to maintain this target range until labour market conditions have reached levels consistent with the FOMC’s assessment of maximum employment, and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time. In addition, the Federal Reserve will continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month until substantial further progress has been made toward the FOMC’s maximum employment and price stability goals.

In the United Kingdom, quarterly GDP increased by 15.5 percent in the third quarter of 2020, after having decreased by 19.8 percent in the previous quarter. Despite the sharp rebound, GDP substantially decreased by 9.6 percent compared with the same quarter of the previous year. The outlook for the economy remains uncertain, given the evolution of infection rates associated with new mutant COVID-19 strains and the measures taken to protect public health. At its December meeting, the Bank of England maintained the Bank Rate at 0.1 percent and confirmed the continuation of its quantitative easing programme, maintaining the total target stock of asset purchases at £895 billion.